

# **Audit Report**

## **Makana Municipality**

For the Year ended 30 June 2012

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MAKANA LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the financial statements of the Makana Local Municipality, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to ....

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), as well as for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

### **Cash and cash equivalents**

4. The municipality processed unsupported journals to balance the bank account in respect of the opening and closing balances. To correct the opening balance, bank was credited and the accumulated surplus debited with R28 million. This was a net amount made up of unknown debits and credits. Similarly, to correct the closing balance, bank was debited and the accumulated surplus credited with R16,6 million. Consequently, unknown income and expenditure or loss items are understated by this amount (2011: R28 million). I was unable to confirm by alternative means which items were understated, and could not determine whether further adjustments were required to the cash and cash equivalents balance per the statement of financial position.

### **Property, plant and equipment**

5. The municipality did not adequately apply the recognition and measurement criteria as per GRAP 17, *Property, Plant and Equipment*, as certain properties in the immovable asset register were not registered in the name of the municipality, and a number of properties were included in the register at incorrect values. Consequently, property, plant and equipment, as recorded in the statement of financial position, is potentially overstated by R225,4 million and the accumulated surplus is overstated by the same amount.

### **Service charges as well as receivables from exchange transactions**

6. Adjustments required to service charges for water and electricity, as recorded in the statement of financial performance, and the corresponding receivables from exchange transactions, per the statement of financial position, could not be adequately determined due to inadequacies in the system used to bill consumers. Consumers are currently billed using incorrect rates, as meter readings are not performed or performed too infrequently to determine an appropriate average rate. The resulting potential misstatement amounts to R51,8 million.
7. Further to the above, service charges as well as corresponding receivables from exchange transactions are potentially overstated by R7,2 million due to incorrect billings recorded on the system.
8. Service charges for the period 15 to 30 June 2012 were not recognised in the financial statements, due to the municipality not implementing adequate cut-off measures. Consequently, service charges, receivables from exchange transactions and service debtors, as disclosed in note 4 to the financial statements, are understated by R6,1 million.

### **Government grants and subsidies received as well as unspent conditional grants and receipts**

9. As per the DoRA allocations, government grants and subsidies received, as recorded in the statement of financial performance, are understated by R5,3 million. Additionally, government grants and subsidies (note 24), sundry debtors (note 5) and receivables from non-exchange transactions are understated by the same amount.
10. I was unable to obtain sufficient appropriate audit evidence to support amounts of expenditure transferred to revenue from unspent conditional grants and receipts in the amount of R11,3 million. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any further adjustments relating to government grants and subsidies received or, correspondingly, unspent conditional grants and receipts were necessary.
11. Further to the above, sufficient appropriate audit evidence was not available for an adjustment to government grants and subsidies received totalling R6,6 million. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the validity of the adjustment by alternative means, and was unable to determine whether any further adjustments to government grants and subsidies received were necessary.

### **General expenditure**

12. The municipality did not provide adequate supporting documentation for payments made during the year, and sufficient appropriate audit evidence was not available for general expenditure recorded in the statement of financial performance and disclosed in note 37 to the financial statements of R27,6 million. I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments relating to general expenditure were necessary.
13. The municipality made duplicate payments to suppliers to the value of R4 million. Consequently, expenditure is potentially overstated and corresponding receivables are understated by R4 million.

#### **Grants and subsidies paid**

14. Grants and subsidies paid, recorded in the statement of financial performance and as disclosed in note 36 to the financial statements, constitute subsidies to indigent debtors. Due to the incorrect calculation of these subsidies, grants and subsidies paid are overstated, and receivables from exchange transactions and the related disclosure of service debtors in note 4 to the financial statements are understated by R11,3 million.

#### **Employee related costs**

15. Employee related costs are recorded in the statement of financial performance and note 29 to the financial statements at R102,7 million (2011: R98,5 million). Documentation in support of employee contracts, allowances, wages and overtime either was not submitted for audit purposes or was incomplete. Furthermore, not all salaried employees and wage earners selected for testing could be physically verified. Consequently, I was unable to confirm the expenditure of R13,6 million by alternative means and to determine whether any further adjustments to employee related costs were necessary.

#### **Inventory**

16. Sufficient appropriate audit evidence was not available to support inventory recorded in the statement of financial position and note 2 to the financial statements at R17,5 million (2011: R9,5 million). The basis for determining the volume and cost of water inventory could not be confirmed. Additionally, consumable stores did not agree to either the general ledger or the values per the inventory system. I was unable to confirm or verify by alternative means the valuation and existence of inventory, due to inadequate record keeping by the municipality. Consequently, I was unable to determine whether any further adjustments to inventory were necessary.

#### **Other receivables and sundry debtors**

17. Sufficient appropriate audit evidence was not available to support other receivables, as disclosed in note 4 to the financial statements at R2,6 million (2011: R9,6 million), and sundry debtors, as disclosed in note 5 to the financial statements at R1,5 million. I was unable to confirm the existence of other receivables or sundry debtors by alternative means, due to ineffective record keeping by the municipality. Consequently, I was unable to determine whether any further adjustments to other receivables and sundry debtors were necessary.
18. The municipality posted an additional adjustment to receivables from exchange transactions and the corresponding note 4 (other receivables) to the financial statements totalling R3,7 million, without sufficient appropriate audit evidence as support. I was unable to confirm the validity of the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustments to other receivables were necessary.

#### **Value-added tax (VAT) payable**

19. The municipality had inadequate procedures to reconcile the VAT liability of R6,5 million disclosed in the statement of financial position to the VAT returns submitted to the South African Revenue Service, resulting in an unexplained difference of R4,5 million. The records of the municipality did not permit the application of alternative procedures. Consequently, I was unable to confirm the valuation, existence and obligation of the VAT payable as disclosed.

## **Payables**

20. Unallocated receipts located in creditors' suspense accounts were incorrectly written off to the accumulated surplus. Consequently, payables recorded in the statement of financial position are understated by R14,5 million, impairment losses per note 32 are understated by R9,7 million, and the accumulated surplus is overstated by R4,8 million.
21. Sufficient appropriate audit evidence was not available to support certain invoices, consumer deposits, journals and suspense account transactions affecting creditors. In addition, the payables amount disclosed in the statement of financial position did not agree to the general ledger. I was unable to confirm the existence and valuation of creditors to the value of R3,8 million (2011: R37 million) as disclosed in note 15 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to payables were necessary.
22. Sufficient appropriate audit evidence was not available for an adjustment made by the municipality to payables totalling R8,6 million. I was unable to confirm the validity of the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustments to payables were necessary.
23. Trade payables raised at year-end were not complete, and as a result expenditure is understated by R6,1 million, VAT is understated by R857 604, and payables are understated by R7 million.

## **Accumulated surplus**

24. Adequate supporting documents could not be provided for journals to the value of R8,6 million (2011: R23,7 million). Consequently, I was unable to determine whether any further adjustments to equity were necessary.

## **Irregular expenditure**

25. The municipality made payments in contravention of the supply chain management (SCM) requirements that were not included in irregular expenditure, resulting in irregular expenditure being understated by R19,4 million.
26. Disclosed in note 43.3 is irregular expenditure of R5,8 million. Neither a schedule of the items making up this amount nor sufficient and appropriate audit evidence was available in support of this irregular expenditure. I was unable to confirm the accuracy or completeness of the irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to irregular expenditure were necessary.
27. Supporting documentation was not submitted for expenditure of R16,3 million. I could not determine whether the correct procurement processes had been followed regarding these transactions and, consequently, irregular expenditure is potentially understated by this amount.
28. A number of employees were paid amounts exceeding the uppermost limits of their approved salary scales. As a result, the irregular expenditure amount as disclosed in note 43.3 could be potentially understated by R3,8 million.
29. The municipality did not have an adequate process for identifying and preventing irregular, unauthorised as well as fruitless and wasteful expenditure. The completeness of irregular expenditure could not be confirmed and the disclosure note is understated by an unknown amount.

### **Unauthorised expenditure**

30. Disclosed in note 43.1 (unauthorised expenditure) are amounts totalling R333,9 million. The municipality incorrectly disclosed all expenditure for the year as unauthorised. The disclosed unauthorised expenditure is therefore overstated by R285,7 million (2011: R275 million).

### **Distribution losses**

31. Section 125(2)(d)(i) of the MFMA requires the disclosure of any material losses in the annual financial statements. The municipality did not have an adequate system for identifying and recognising material losses of water and electricity. Due to this lack of systems, it was impracticable to determine the full extent of the misstatement of losses as disclosed in note 44.9 to the financial statements. The distribution losses of R9,7 million (2011: R9,7 million) disclosed in the current and corresponding figures are identical, yet the corresponding figures as disclosed do not agree to those disclosed in the prior year financial statements.

### **Commitments**

32. The municipality did not maintain a complete and accurate contracts or commitments register or contracts register. The commitments disclosed in note 45 to the financial statements were identified during the audit process. Consequently, the completeness of the amounts disclosed could not be confirmed and the commitments disclosure is understated by an unknown amount.

### **Disclosure notes – property rates**

33. Included in property rates (note 23 to the financial statements) are property valuations disclosed as R10,7 billion (2011: R10,7 billion). Per the valuation roll, these values are overstated by R736,7 million (2011: R547,3 million).

### **Corresponding errors**

34. In the prior year, the municipality did not adequately apply the recognition and measurement criteria as per GRAP 17, *Property, Plant and Equipment*, as certain properties in the immovable asset register were not registered in the name of the municipality, and a number of properties were included in the register at incorrect values. Consequently, property, plant and equipment in the comparative figures is potentially overstated by R171,6 million, depreciation is understated by R63,6 million, the VAT receivable is understated by R3 million, and the accumulated surplus is overstated by R105 million.

35. The prior year comparative figure for other revenue was restated and increased by R9,4 million in order to recognise the water inventory as per note 39 to the financial statements. The basis for calculating the water inventory could not be confirmed and consequently the comparative figure for other revenue is overstated by R9,4 million.

36. The municipality made an adjustment to the comparative figures totalling R16,5 million, crediting VAT and debiting impairment losses. No supporting evidence was submitted to substantiate the adjustment. Consequently, in the corresponding figures, the VAT receivable is understated and impairment losses are overstated by R16,5 million.

37. The auditor's report for the year ended 30 June 2011 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. Certain matters that gave rise to the limitation, as described below, remain unresolved in the current year.

38. The municipality could not provide sufficient appropriate audit evidence regarding the following:

- Additions to property, plant and equipment of R15,8 million
- Accrued leave of R5 million
- Accumulated surplus of R23,7 million
- Cash and cash equivalents of R40,8 million

#### **Correction of error**

39. Prior period errors should be corrected and disclosed in accordance with GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, which requires that material prior year errors be corrected retrospectively in the first set of financial statements authorised to be issued after discovery of these errors, by restating the comparatives for the prior period(s) presented in which the error occurred. Sufficient appropriate audit evidence could not be provided for all the prior period errors as disclosed in note 39 to the financial statements in respect of the following element making up the statement of financial position and statement of financial performance:

- Non-current assets – R10,3 million

40. I was unable to confirm these adjustments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary.

#### **Aggregation of immaterial uncorrected misstatements**

41. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the notes to the financial statements:

- Non-current assets reflected as R1,5 billion are understated by R556 597
- Current assets reflected as R116,9 million are understated by R761 815 (2011: R3 million)
- Non-current liabilities reflected as R56,2 million are understated by R440 361
- Current liabilities reflected as R133,1 million are understated by R930 264 (2011: R44 376)
- Total revenue reflected as R323,5 million is overstated by R1,1 million (2011: R52 945)
- Total expenditure reflected as R334 million is overstated by R1,8 million (2011: R126 403)
- Accumulated surplus reflected as R1,4 billion is overstated by R324 568
- Disclosure notes are misstated as follows:
  - Related parties reflected as Rnil are understated by R350 509
  - Irregular expenditure reflected as R5,8 million is understated by R3,5 million
  - Contingent liabilities reflected as R6,2 million are understated by R2 million

42. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm or verify the following elements by alternative means:

- Non-current assets reflected as R5,2 million
- Current assets reflected as R1,6 million
- Non-current liabilities reflected as R356 377
- Current liabilities reflected as R2,5 million
- Total revenue reflected as R3,3 million (2011: R186 810)
- Total expenditure reflected as R1,3 million
- Accumulated surplus reflected as R1,9 million
- Prior year correction of impairment of debtors reflected as R2,7 million

43. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

#### **Disclaimer of opinion**

44. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

#### **Emphasis of matters**

45. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Material losses and impairments**

46. As disclosed in note 32 to the financial statements, material losses of R29,7 million were incurred as a result of writing off irrecoverable trade debtors and increasing the provision for the impairment of debtors.
47. Additionally, disclosed in note 44.9 to the financial statements, material losses of electricity to the amount of R2,6 million and of water to the amount of R7,2 million were incurred as a result of faulty meters, meters being tampered with and illegal connections.

#### **Material underspending of the budget**

48. As disclosed in appendix D to the financial statements, the municipality materially underspent the capital budget as well as the budget on planning and development and public safety, in spite of the municipal budget being overspent in total. As a consequence, the municipality did not achieve 51,2% of its planned objectives for the year.

#### **Additional matter**

49. I draw attention to the matter below. My opinion is not modified in respect of this matter.

#### **Unaudited supplementary schedules**

50. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

51. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

52. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

53. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
54. The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
55. The material findings are as follows:

#### **Usefulness of information**

##### **Presentation**

##### **Measures taken to improve performance not disclosed**

56. Improvement measures for a total of 25% of the planned targets not achieved were not disclosed in the annual performance report, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures for the processes pertaining to the reporting of performance information.

##### **Consistency**

##### **Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

57. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of the reported objectives, 82% of the indicators and 41% of the targets were not consistent with the objectives, indicators and targets as per the approved integrated development plan. This was due to a lack of appropriate processes and procedures to report against predetermined objectives.

##### **Measurability**

##### **Performance targets not specific**

58. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. Thirty-three per cent of the indicators were not well defined, specific or time bound.

## **Reliability of information**

### **Validity**

59. The FMPPI requires that processes and systems that produce the indicator be verifiable and accurate enough for its intended use and respond to changes in the level of performance. A total of 20% of the reported performance relevant to the objective: promoting a culture of reading and learning, 50% of the reported performance relevant to the objective: providing access to safe drinking water, and 25% of the reported performance relevant to the objective: contributing towards housing provision, was not valid and accurate when compared to the source information or evidence provided. This was due to a lack of monitoring and review as well as standard operating procedures not being adhered to for the recording of reported information by senior management.

### **Accuracy**

60. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy of the actual reported performance relevant to 67% of the objective: providing good quality roads and storm water drainage. This was due to limitations placed on the scope of my work due to the absence of information systems relating to performance reporting and the institution's records not permitting the application of alternative audit procedures.

### **Additional matter**

61. I draw attention to the matter below. This matter does not have an impact on the audit findings on predetermined objectives reported above.

### **Achievement of planned targets**

62. As reported in the annual performance report, only 48,8% of the planned targets were achieved during the year under review. The main reason for the underachievement was the lack of financial resources to implement targets.

### **Compliance with laws and regulations**

63. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

### **Budgets**

64. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

65. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

66. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

## **Annual financial statements, performance report and annual report**

67. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatement of non-current assets, current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
68. The annual report for the year under review did not include an assessment by the accounting officer of any arrears on municipal taxes and service charges or particulars of any corrective action taken or to be taken in response to issues raised in the audit report, as required by section 121 of the MFMA.
69. The annual report did not contain the performance of external service providers, a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.

## **Audit committee**

70. The audit committee did not advise the council, accounting officer and management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, resulting in non-compliance with section 166(2)(a)(iv) of the MFMA.
71. The audit committee did not advise the council, accounting officer and management staff on matters relating to compliance with the MFMA, DoRA and the MSA, as required by section 166(2)(a)(vii) of the MFMA.
72. The audit committee did not, at least twice during the financial year, submit an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation (MPPMR) 14(4)(a)(iii).

## **Internal audit**

73. The internal auditors did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the audit committee, as required by MPPMR 14(1)(c). This was due to the fact that quarterly reports were not completed and submitted to the internal auditors within a reasonable and effective time frame.

## **Procurement and contract management**

74. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, as required by SCM Regulation 17(a) and (c).
75. Quotations were accepted from prospective providers who were not registered on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM Regulations 16(b) and 17(b).
76. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value above R200 000 had been procured by inviting competitive bids, as per the requirements of SCM Regulations 19(a) and 36(1).

77. Sufficient appropriate audit evidence could not be obtained that bid specifications had been drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM Regulation 27(3).
78. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding had been advertised for the required minimum period, as required by SCM Regulation 22(1) and 22(2).
79. Sufficient appropriate audit evidence could not be obtained that bids had been evaluated by bid evaluation committees composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM Regulation 28(2).
80. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
81. Sufficient appropriate audit evidence could not be obtained that bid adjudication had always been done by committees composed in accordance with SCM Regulation 29(2).
82. Sufficient appropriate audit evidence could not be obtained that awards had not been made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM Regulation 29(5)(b).
83. Sufficient appropriate audit evidence could not be obtained that contracts and quotations had been awarded to suppliers based on preference points allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.
84. Sufficient appropriate audit evidence could not be obtained that contracts had only been extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
85. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts had been approved by a properly delegated official, as required by SCM Regulation 5.
86. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
87. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
88. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM Regulation 46(2)(e) and the code of conduct for staff members issued in terms of the MSA.
89. Allegations of fraud, corruption and improper conduct or failure to comply with the SCM system laid against officials or role players in the SCM system were not investigated, as required by SCM Regulation 38(1)(b).
90. Sufficient appropriate audit evidence could not be obtained that construction contracts had been awarded to contractors registered with the Construction Industry Development Board (CIDB) and had qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB Regulations 17 and 25(7A).
91. The accounting officer failed to implement measures to combat the abuse of the SCM system, contrary to the requirements of SCM Regulation 38(1).
92. Sufficient appropriate audit evidence could not be obtained that all contracts and

quotations had been awarded in accordance with the legislative requirements and a procurement process that was fair, equitable, transparent and competitive.

#### **Human resource management and compensation**

93. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the Regulation on Minimum Competency Levels 14(2)(b).
94. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
95. The municipal manager, who was suspended during May 2012, did not sign a performance agreement, as required by section 57(2)(a) of the MSA.

#### **Expenditure management**

96. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
97. An effective system of expenditure control was not in place, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
98. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors, as required by section 65(2)(b) of the MFMA.
99. The accounting officer did not take effective steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
100. Irregular expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

#### **Conditional grants**

101. The municipality did not evaluate its performance in respect of programmes funded by Schedule 4 allocations and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by sections 11(6)(a) and 12(6) of DoRA.
102. The municipality did not submit MFMA implementation plans to the National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
103. The municipality did not certify to the National Treasury that it had included each programme funded by the schedule 4 allocation in its annual budget or made public the conditions of the schedule 4 allocation, as required by section 11(2)(a) of DoRA.
104. Monthly budget statements did not include the municipality's quarterly assessment of its spending and financial performance against its entire capital budget or performance against the targets stipulated in the infrastructure performance framework, as required by section 11(2)(b)(ii) of DoRA.

105. Quarterly reports were not submitted to the transferring national officer and the National Treasury on municipal performance for the quarter against the targets stipulated in the infrastructure performance framework, within 30 days after the end of each quarter, as required by section 11(2)(c)(ii) of DoRA.
106. Sufficient appropriate audit evidence could not be obtained that allocations from conditional grants had not been utilised for purposes other than those stipulated in the grant framework, in contravention of section 15(1) of the DoRA.
107. Sufficient appropriate audit evidence could not be obtained that unspent conditional grant funds not committed to identifiable projects and/or not approved by the National Treasury for retention had been surrendered to the national revenue fund, as required by section 20(1) of DoRA.
108. The municipality did not submit a draft performance framework by 30 March 2011, the final approved performance framework by 7 June 2011 as well as the human settlement and built environment performance framework and proof that the performance framework and the performance targets had been ratified by a municipal council resolution prior to receipt of its first instalment of the grant allocation, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
109. The municipality did not submit the 2010-11 annual report to the national Department of Human Settlement on or before 30 September 2011 and to the National Treasury by 15 December 2011, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
110. The municipality did not submit quarterly performance reports to the transferring national officer, the provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
111. The municipality did not submit, within the prescribed time frames, project registration forms for projects it intended implementing in the financial year under review to the Department of Local Government, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
112. The municipality did not submit project implementation plans to the national Department of Cooperative Governance and Traditional Affairs, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280. The municipality did not register its master plans for bulk infrastructure with the Integrated National Electrification Programme, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
113. Projects were not implemented in line with the details contained in the integrated development plan, as required by the Division of Revenue Grant Framework, issued in Gazette No. 34280.
114. The municipality did not comply with the preparations for the next financial year and the 2013-14 financial year, as required by section 26 of DoRA, in that projects to be funded from the allocations for the next financial year were not submitted to the national transferring officer and the final allocations were not submitted to the National Treasury by 7 December 2011.

#### **Revenue management**

115. An adequate management, accounting and information system was not in place to recognise revenue when it was earned, as required by section 64(2)(e) of the MFMA.

#### **Asset management**

116. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.

117. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
118. Not all investments were made in accordance with the requirements of the investment policy, as required by Municipal Investment Regulation 3(3).

#### **Liability management**

119. A management, accounting and information system was not in place to adequately account for liabilities, as required by section 63(2)(a) of the MFMA.
120. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

#### **Internal control**

121. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

122. Top management did not demonstrate effective leadership based on ethical business practices and good governance, protecting and enhancing the best interest of the municipality, as was the case in the prior year. During the year under review, the chief financial officer remained suspended and was then dismissed for irregularities pertaining to SCM. The municipal manager was suspended and investigated during the year under review for potential irregular appointments, other SCM-related irregularities and the non-performance of the municipality.
123. Insufficient focus was placed on quality, as it was not understood to be a prerequisite. This is evidenced by the significant findings on internal control, financial management and reporting on predetermined objectives. Furthermore, the misstatements of the prior financial year had not been addressed and were repeated in the current year. This was also the case in previous financial years, with the result that the misstatements of at least the prior two financial years have not been sufficiently addressed.
124. Management was not able to implement effective human resource management to ensure that adequate and sufficient skilled resources were in place and that performance was monitored. This contributed to the significant number of material misstatements identified in the financial statements, findings on predetermined objectives and non-compliance with laws.
125. The accounting officer did not exercise adequate oversight responsibility over reporting, compliance with laws and regulations or internal control. This is evidenced by the number of findings related to procurement (SCM). As a result, unauthorised and irregular expenditure was incurred, as disclosed in the financial statements.

126. Although management developed an action plan to address the external audit findings of the prior years, the implementation of the plan was not adequately monitored, resulting in similar findings occurring in the current financial year.
127. The municipality did not have an adequately documented and approved information technology (IT) governance framework to provide comprehensive guidelines for IT decision-making. In addition, the IT risk framework and IT strategic plan were inadequately documented, implemented and approved. These deficiencies can be attributed to the fact that IT governance was not a priority for the municipality, as attempts to address prior year findings were inadequate.

#### **Financial and performance management**

128. The municipality did not have proper record keeping and record management systems, resulting in documents supporting the transactions and balances in the financial statements not being properly filed and easily retrievable. This contributed to pervasive material scope limitations and a number of material suspense accounts not being reconciled at year-end.
129. Quality and reliable financial statements and performance reports were not prepared, as staff did not have knowledge of the GRAP reporting framework and performance management requirements. This was evidenced by the fact that many material adjustments were required to the financial statements. Consequently, the financial statements initially submitted on 30 September 2012 did not comply with section 122(1)(a) of the MFMA, since the financial statements did not fairly present the state of affairs of the municipality and its financial results and financial position at the end of the financial year.
130. The implementation of controls over daily and monthly processing and reconciling of transactions was not effective and resulted in inaccurate financial reporting. Suspense accounts were not reconciled, suppliers were not reconciled to statements, while fixed asset register, investment, bank and VAT reconciliations were not adequately prepared or not prepared with sufficient frequency. Irregular practises, including unsupported journal entries and the apparent force-balancing of the bank account to the accumulated surplus, may indicate unauthorised withdrawals and other potentially fraudulent activity.
131. The review and monitoring of compliance with laws and regulations were not effective, as numerous instances of non-compliance were identified, relating to:
  - expenditure management
  - revenue management
  - asset management
  - budget
  - annual financial statements and annual performance report
  - procurement and contract management.
132. The IT control environment was generally weak, mainly due to the fact that this area has not been a priority of the municipality.

#### **Governance**

133. Appropriate risk management activities relating to financial reporting, performance reporting and compliance with laws and regulations were not implemented during the financial year. There was also no approved IT risk and control framework or IT risk register.

134. Cognisance is taken of the work done by the internal audit unit, but the effectiveness of the unit was hampered by the limited budget allocated to this important function, which therefore had a direct impact on its effectiveness as well as that of the audit committee. As a result, the internal audit unit did not function as envisaged by section 165(2) of the MFMA. The internal audit unit only reviewed and reported on the performance reports relating to the first two quarters of the performance year, given the late submission of the further quarters' information. The annual performance report submitted for auditing was not reviewed by the internal audit unit and reported on to the audit committee.
135. Although the municipality had an audit committee, it did not effectively discharge its duties as envisaged by section 166 of the MFMA.
136. The number of findings related to misstatements in the financial statements, performance reporting and non-compliance with laws and regulations indicates that more oversight is required.

## OTHER REPORTS

### Investigations

137. As disclosed in note 43.3 to the financial statements, investigations into several alleged transgressions resulting in irregular and potential irregular expenditure are currently being conducted.

*Auditor-General.*

East London

1 February 2013



*Auditing to build public confidence*